UNIVERSITY OF MAINE SYSTEM
Board of Trustees

Investment Committee

December 5, 2017
University of Maine System – Executive Offices
Rudman Conference Room, 253 Etabrooke Hall, Orono

Present: Committee Members: Karl Turner, Chair (at USM), Mark Gardner (by phone), and Kelly Martin (at UMFK). **Other Trustees**: Betsey Timm (at USM). **Non-Voting Committee Members**: Robert Blackwood (at USM), Peter Handy (by phone), and Erik Hayward (at USM). **Staff:** Tracy Elliott (at USM), Ellen Doughty, and Ryan Low. **Others:** Mike Pratico – CAPTRUST (at USM), Kelly Regan – NEPC (at USM), Jay Roney – NEPC (at USM), Barron Schmitt – CAPTRUST (at USM), and John Shipway – MMA (at USM).

Absent: Committee Members: James Donnelly, James Erwin, and Shawn Moody.

Trustee Turner, Chair, called the meeting to order.

Defined Contribution Plan – Vendor Fee Update. CAPTRUST Financial Advisers representatives, Mr. Mike Pratico and Mr. Barron Schmitt, summarized the formal Fee Benchmarking study which Mr. Pratico presented at the September Committee meeting and the progress made since then. At the September meeting, CAPTRUST concluded that TIAA's 8 basis point (bps) pricing target, while reasonable, had room for further negotiation.

TIAA has since offered to reduce the target revenue from 8 bps (.08%) of plan assets to 6.5 bps (.065%) resulting in savings to UMS plan participants of approximately $210,000 a year. CAPTRUST compared the 6.5 bps target to the pricing of other plans with similar size, average account balance and complexity and believes that the proposed target is appropriate. As such, CAPTRUST recommended that the Committee accept the revised pricing offer and the proposed 2 year contract period.

CAPTRUST noted that the UMS plan would not be at the low end of the pricing spectrum, as TIAA currently record keeps 7 plans for UMS which is expensive.

The Committee discussed the high percentage of plan assets held in the TIAA Traditional and CREF Stock options. CAPTRUST noted that this is common for higher education plans that have been with TIAA for decades as those were two of only four options in the original TIAA contract offerings. Further, the TIAA Traditional Account requires a 9 year and 1 day liquidation process. Committee members also commented about the expenses of the TIAA and CREF offerings and their fiduciary responsibility to ensure such costs are appropriate.

Committee members who were present supported the acceptance of the revised lower TIAA administrative expense pricing of 6.5 basis points effective January 1, 2018. Lacking a quorum, this item will be forwarded to the January Board of Trustee's meeting for approval.

Defined Contribution Plan – Quarterly Review. Mr. Pratico and Mr. Barry Schmitt, Senior Vice Presidents with CAPTRUST Financial Advisors, provided a quarterly update regarding the Defined Contribution Plan. The Plans held $1.4 billion in assets as of September 30, 2017 with $1.4 million transferred in from alternate carriers during the quarter.

CAPTRUST provided the following brief Market Commentary: All asset classes moved higher in the 3rd quarter and remain in positive territory for the calendar year. Both U.S. and international stocks have notched gains each month of calendar 2017, leading them to double-digit gains for the year so far. Meanwhile, other asset classes have posted modest but positive returns. U.S. stocks continued their rally into record territory this 4th quarter to date, driven by positive corporate earnings reports and contained inflation. Both developed and emerging market international stocks surged in the 3rd quarter on the uptick in global growth. Bonds fell modestly in September as interest rates rose. Nonetheless, they inched higher during the 4th quarter and have managed a small gain for the year.

Plan investments were reviewed consistent with the Investment Policy Statement. All funds, with one exception, are in good standing. CAPTRUST emphasized the following:

***Vanguard Target Date Funds* –** CAPTRUST continues to believe that the Vanguard Target Date series is an excellent choice and default option for participants in the UMS plan. The funds are amongst the highest scoring funds that CAPTRUST follows. CAPTRUST noted a high level change within Vanguard's senior management team which caused no change in their scoring of the funds.

***TIAA Traditional* –** TIAA Traditional continues to be an appropriate choice for plan participants with a yield well above industry averages. Though less liquid than most of its peers (9 year and 1 day payout under most contracts), CAPTRUST continues to believe it is an appropriate choice for many participants and can be an important part of a participant's retirement strategy.

CREF Stock – For participants looking for a largely actively managed Global Equity fund, CREF Stock continues to be an appropriate choice. The fund is well diversified across several asset classes and has expenses well below industry averages.

The Goldman Sachs Mid Cap Growth fund - Based on the CAPTRUST scoring methodology, this fund is currently marked "consider for termination". See below for further discussion of this fund.

Defined Contribution Plan – Mid Cap Growth Manager Review.

***Goldman Sachs Growth Opportunities*:** Following a disappointing performance in calendar 2015, the strategy again lagged its peers and the benchmark in calendar 2016. The strategy outperformed in the first half of 2016, but lagged significantly in the second half due to a rally in lower quality stocks. CAPTRUST noted that near term performance has been strong. Calendar year to date, through early December, the fund is up 25+% in absolute terms and in the top quartile peer relative. For the trailing one-year period, through early December, the fund is in the top third peer relative and up 27+% in absolute terms. CAPTRUST recommends retaining Goldman Sachs and close scrutiny in the coming months which was supported by the Committee members present. Lacking a quorum, this item will be forwarded to the January Board of Trustee's meeting for approval.

Defined Contribution Plan – TIAA & Issues Raised. TIAA was the focus of an October 21, 2017, *New York Times* article regarding the company's aggressive sales practices suggesting that TIAA pushed clients into higher priced investments, not in their best interests, and that its employee training materials encouraged this practice.

CAPTRUST noted that TIAA, like almost all other financial services organizations, is in the business of gaining “wallet share”, or cross selling other products and services beyond the core 403(b) account held by most participants. Following the article, Mr. Pratico, Mr. Schmitt, and Ms. Tracy Elliott, Vice President of Finance and Controller, met with TIAA representatives to review the products and services being offered and to discuss the article in detail. In addition, CAPTRUST benchmarked the fees of many of TIAA’s ancillary services and determined that the costs are competitive with other financial services firms. In addition, Managed Accounts (which were cited in the article), are not offered at UMS. Finally, CAPTRUST noted the open architecture recordkeeping platform which allows participants to select from a menu which includes TIAA products and those of other firms. As a result, participant cash flows over time are increasing in the nonproprietary products. CAPTRUST agreed to continue to monitor TIAA and update the Committee on further developments.

Defined Contribution Plan – Roth Option. Mr. Pratico and Mr. Schmitt talked about the advantages of adding a Roth option to the Defined Contribution Plan. They explained the difference between a traditional (pre-tax) contribution to a 403b and a Roth (post tax) contribution.

Benefits of adding a Roth contribution option to the plan include:

- Meeting changing retirement plan needs of UMS and its participants.
- Enhancing the plan by providing participants with an opportunity to save more for retirement.
- Allowing contributions to be made on an after-tax basis.
- Providing higher contribution limits to participants than a Roth IRA provides.
- Providing additional flexibility, including protection against future tax rates, to participants when planning retirement income.
- Providing tax diversification opportunities to participants as qualified distributions are 100% tax free.

CAPTRUST believes that offering a Roth option for participants to consider makes sense.

Ms. Tracy Elliott has also discussed the Roth option internally with Human Resources and Information Technology (IT) leadership. TIAA has described the project scope as relatively small with a quick implementation timeline. Ms. Elliott submitted a Project Initiation Form to IT in early October. The Committee further discussed the Roth option and UMS will continue the process internally.

FY2019 Endowment Spending Rate. Ms. Tracy Elliott reviewed the proposed Fiscal Year 2019 (FY2019) endowment spending rate. Last March, when the Investment Committee approved the FY2018 endowment distribution rate per share, the Committee asked that the spending rate discussion occur earlier in the budget cycle so that changes could easily be made if warranted.

Background

The endowment spending rate has been 4.5% since FY2013, being adjusted down from 4.75% in FY2012 and 5% in FY2011. These adjustments were made to ensure the sustainability of the long-term spending ability of the endowment funds.

The current FY2018 spending rate of 4.5% (which includes an internal management fee, where charged) is currently estimated to generate a distribution of $5.5 million for the year, including

$4.4 million for endowed spending and $1.1 million for internal management fees. The FY2018 **effective spending rate** for the University of Maine System (UMS) is 3.5%.

Effective Spending Rate Defined: The distribution for spending divided by the beginning market value (endowment value on or around the beginning of the fiscal year), net of any fees or expenses for managing and administering the endowment. The distribution for spending is the dollar amount withdrawn from the endowment to support the institution's mission.

NACUBO Commonfund Study of Endowments: Annually, the National Association of College and University Business Officers (NACUBO) and Commonfund Institute report on endowment performance and management practices in higher education. Their most recent 2016 report shows the average **effective spending rate** for their 805 participants to be 4.3%. For the category based on assets of $101-500 million, the effective spending rate is also 4.3% up from 4.1% in the prior year. For 2016, the UMS effective spending rate was in line at 4.2%.

NEPC Rate of Return Assumption: NEPC updated the return expectations for the UMS Managed Investment Pool in July 2017. Their analysis suggests that a return expectation in the range of 6.5% to 7.5% is reasonable. NEPC's return expectations will likely change following an update to their asset allocation projections in January 2018 and the adoption of related recommendations by the Committee at its March 8, 2018 meeting; however, Mr. Roney noted that their 30 year return assumption might not go down.

FY2019 Endowment Distribution Rate Per Share and Estimated Budget: Using the approved endowment spending rate for FY2019, management will present an information item to the Committee at its March meeting detailing the distribution rate per share and the resulting estimated amounts.

Distribution Rate Calculation: The distribution formula uses a 3-year rolling endowment pool market value average to which a percentage spending rate is applied. The resulting distribution amount is then divided by the total number of shares in the endowment pool to arrive at the distribution rate per share. The UMS Accounting Department uses the approved rate per share in the monthly allocation process whereby each endowment receives a distribution based on the respective number of shares held. UMS does not distribute funds for underwater endowments during the following fiscal year.

Recommendation: The UMS Chief Business Officers support an endowment spending rate of 4.5% and management recommends that this rate be continued for FY2019.

Following discussion, the Committee members expressed support for the proposed 4.5% endowment spending rate. Lacking a quorum, this item will be forwarded to the January Board of Trustee's meeting for approval.

Performance Review – Managed Investment Pool, Pension Fund and Operating Fund. Ms. Kelly Regan and Mr. Jay Roney of NEPC reviewed performance for all three UMS portfolios with the following highlights.

> ***Managed Investment Pool (MIP)***. The MIP returned 2.8% fiscal year-to-date and 11.0% calendar-year-to-date as of September 30th. These returns ranked in the 84th and 64th percentile in the InvestorForce Endowments and Foundation $100-500 million universe, respectively. Managers detracted 90 and 80 basis points of value during these time periods, respectively, with emerging market equity, hedge funds and a select global asset allocation manager detracting the most value relative to benchmarks.

Defined Benefit Pension Fund. The Pension returned 1.8% fiscal year-to-date and 7.5% calendar-year-to-date as of September 30th. These returns ranked in the 87th and 82nd percentile in the InvestorForce Total Fund Universe due to the conservative asset allocation and low equity exposure. Managers detracted 120 and 180 basis points of value during these time periods, respectively, with emerging market equity, hedge funds and a select global asset allocation manager detracting the most value relative to benchmarks.

Operating Fund. The Operating Fund returned 1.0% fiscal year-to-date and 3.3% calendar-year-to-date as of September 30th. The Operating Fund had the lowest return compared to the other two portfolios given the very conservative risk profile of the Fund. Managers detracted 10 and 30 basis points of value during these time periods. Most managers were ahead or in-line with their stated benchmarks and the two detractors were the hedge fund manager and a select global asset allocation manager.

Environmental, Social and Governance (ESG) Update. Ms. Regan and Mr. Roney provided an update regarding ESG trends in the industry. The number of organizations considering ESG continues to grow as does the assets being invested with ESG principles. NEPC provided an update regarding the MIP's investment managers - 14 managers have signed on as signatories with the Principles for Responsible Investing (PRI) which is roughly 88% of the portfolio's assets. NEPC and the Committee will continue to work towards implementing ESG across the portfolio and will review the MSCI ESG report at an upcoming meeting.

Adjournment

Submitted by
Tracy Elliott for
Ellen Doughty, Interim Clerk